uniongas

A Duke Energy Company

unionGas
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J.L. (Jane) Peverett
President

March 27, 2003

Dear Shareholder:

I am pleased to forward you a copy of the Union Gas 2002 annual report. It contains Union's financial results, balance sheet and income statement, management's discussion and analysis, statement of corporate governance and corporate directory.

I invite you to visit *www.sedar.com* for electronic versions of Union Gas's 2002 financial statements, management's discussion and analysis, and other filings throughout the year.

JPeverett

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Union Gas Limited

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis should be read in conjunction with the financial statements and accompanying notes.

GENERAL

Union Gas Limited ("the Company" or "Union") was incorporated under the laws of the Province of Ontario by letters patent dated December 19, 1911. Westcoast Energy Inc. ("Westcoast") owns all of the outstanding common shares of the Company.

On March 14, 2002, Duke Energy Corporation ("Duke Energy"), through a subsidiary, acquired Westcoast, Union's parent company, for approximately US$8 billion, including the assumption of US$4.7 billion of debt. In the transaction, Duke Energy acquired all of the outstanding common shares of Westcoast in exchange for Duke Energy common shares and cash.

HIGHLIGHTS

Years Ended December 31 ($millions)	**2002**	2001
Earnings applicable to common shares *($millions)*	**109**	116
Distribution volumes $(10^6 m^3)$ [1]	**14,883**	13,896
Transportation volumes $(10^6 m^3)$	**22,347**	18,613
Customers *(thousands)*	**1,171**	1,147
Heating Degree Days *(degrees celsius)* [2]	**3,976**	3,749

Note 1: $10^6\ m^3$ equals millions of cubic meters

Note 2: A heating degree day is a measure of temperature that identifies the need for heating. A degree day occurs when the temperature dips below 18 degrees Celsius. A temperature of 0 degrees Celsius equals 18 degree days.

The Company is a Canadian natural gas utility that provides natural gas distribution, transmission and storage and related services to more than one million residential, commercial and industrial customers in over 400 communities in northern, southwestern and eastern Ontario. Its distribution service area extends throughout northern Ontario from the Manitoba border to the North Bay/Muskoka area, through southern Ontario from Windsor to just west of Toronto, and across eastern Ontario from Port Hope to Cornwall. The Company also provides natural gas storage and transportation services for other utilities and energy market participants in Ontario, Quebec and the United States.

RATE REGULATION

The Company is subject to regulation by the OEB. As a result, the Company records assets and liabilities that result from the regulated ratemaking process. Regulatory assets represent incurred costs that have been deferred because they are probable of future recovery in customer rates. Regulatory liabilities generally represent obligations to make refunds to customers for previous collections for costs that are not likely to be incurred. Management continually assesses whether the regulatory assets are probable of future recovery by considering various factors and believes that the existing regulatory assets are probable of recovery.

Prior to 2001, rates were typically set under cost of service regulation to recover revenues equal to the forecast costs of the Company, including operating, maintenance and administrative costs, and including debt and equity costs of financing capital investment.

In July of 2001, the OEB approved a trial form of Performance Based Regulation ("PBR") for establishing Union's rates for the years 2001 through 2003, which fixed the allowed rate of return on common equity in rates at the 2000 level of 9.95%. For the years 2001 through 2003, rates are adjusted by formula from the 2000 rate level by a rate escalator that is increased for annual inflation (the change in the national Gross Domestic Product Price Index) less a fixed factor of 2.5% to provide for productivity gains. There is some pricing flexibility allowed, including the ability to negotiate longer-term rates with customers. Certain items, such as the cost of purchasing gas, will continue to be passed through to customers at cost, the same treatment as existed under cost of service regulation. An earnings sharing mechanism with a band around the approved return on equity ("ROE") of one percentage point after taxes was also established. This mechanism provides equal sharing of any earnings variance outside the band between customers and shareholders. The approved return on equity for purposes of setting the band for earnings sharing is determined annually using the OEB formula for ROE and may not reflect the ROE recovered through rates. Under the PBR plan, the Company accepts somewhat more risk than under cost of service regulation in exchange for an increased opportunity to benefit from growth and cost efficiency.

In September 2002, the OEB issued its decision on the Company's application for 2001 and 2002 rates. The OEB approved inflation factors of 3.9% and 2.0% to be used in the Company's rate escalator formula for 2001 and 2002, respectively, resulting in an increase in customer rates of 1.4% in 2001 and a decrease of 0.5% in 2002. The OEB also approved the pass through to customers of the impact of changes in gas costs during 2000 and 2001. The recovery of the revenue resulting from approved rate changes and deferred gas costs amounting to approximately $141 million will be charged to customers in the period January through June 2003.

As part of PBR, the Company is required to go through a customer review process. The customer review process is a settlement negotiation that addresses the specific PBR parameters and other matters such as the disposition of deferral accounts for the applicable period. A hearing is then held before the OEB to approve the settlement and hear evidence on unresolved issues.

The Company is currently undergoing the process of seeking approval of its 2003 rates. The Company received OEB approval in February 2003 of the settlement agreement negotiated in a customer review meeting in January 2003. The agreement settled many financial and operating issues for 2003, including a rate decrease of 2.3% effective January 1, 2003 pursuant to the rate escalator formula set by the OEB. A hearing was held with the OEB in February 2003 to address various outstanding issues relating to the 2003 year. A decision is pending.

The Company plans on filing a cost of service rate application in the second quarter of 2003 to establish 2004 rates and expects to file a proposal for second generation PBR for 2005 in the fourth quarter of 2004.

OPERATING RESULTS

Earnings

Years Ended December 31 ($millions)	**2002**	2001
Gas distribution margin	**631**	604
Transportation and storage revenue	**179**	151
Other revenue	**39**	44
Expenses	**504**	457
Interest expense	**168**	179
Income taxes	**63**	42
Net income	**114**	121
Earnings applicable to common shares	**109**	116

Net income for 2002 was $114 million compared with $121 million in 2001. After deducting preference share dividends, earnings applicable to common shares were $109 million in 2002 and $116 million in 2001. The decrease in earnings in 2002 is primarily due to bad debt expense, severances, income tax expense and a write-down of Natural Gas Vehicle assets. These costs were partially offset by colder weather than 2001, increased customer usage and lower interest rates.

Weather, measured in heating degree-days, was 6.1% colder in 2002 compared with 2001. As a result of weather, earnings increased in 2002 compared to 2001 by approximately $7 million.

The Company entered into a weather hedge with a counter party in order to mitigate the risk of warm weather during November and December 2002. The hedge contract provided that the Company would receive a payment from the counter party if weather was warmer than forecast, in exchange for agreeing to a payout to the counter party if weather was colder than forecast. Because the period defined by the contract experienced colder weather, the Company paid out $2 million to the counter party. This payment was recorded as a reduction of the Company's gas sales and distribution revenues.

The Company and an affiliated company have entered into contracts with a counter party to mitigate the risk of warm weather during 2003. The hedge contract provides protection against warm weather and the Company is obligated to make a payment to the counter party in the event weather is cold. The maximum payout under the hedge is $25 million. Any payment would be recorded as a reduction of the Company's gas sales and distribution revenues. In conjunction with this contract, the Company received a premium of $4.5 million from the counter party for selling the portion of the contract related to the potential for colder weather. The $4.5 million has been recorded as a current liability.

Quarterly Results

	For the quarters ended			
($millions)	Mar	June	Sept	Dec
2002				
Operating revenues	560	277	254	498
Net income (loss)	101	(5)	(17)	35
Net earnings (loss) applicable to common shares	100	(7)	(18)	34
2001				
Operating revenues	656	361	393	473
Net income (loss)	83	(5)	(8)	51
Net earnings (loss) applicable to common shares	82	(7)	(9)	50

After deducting preference share dividends, the income for the three months ended December 31, 2002 was $34 million compared with $50 million for the same period in 2001.

The decrease in earnings compared to the fourth quarter of 2001 was primarily due to higher operating costs, bad debt expense, severances and income tax expense, partially offset by colder weather and higher demand for storage and transportation services.

Gas Distribution Margin

The gas distribution margin was $631 million in 2002 compared with $604 million in 2001. The increase in the margin was largely due to colder weather in 2002, increased usage and customer growth, partially offset by lower delivery rates in 2002.

Most of the Company's industrial and commercial customers, and a portion of residential customers, purchase their natural gas supply directly from suppliers or marketers. As the Company earns income from the distribution of natural gas and not the sale of the natural gas commodity, the gas distribution margin is not affected by the source of the customers' gas supply.

Revenue from gas sales and distribution services provided but not billed is estimated each month based on the number of days unbilled, heating degree-days and historic consumption per heating degree-day. Unbilled revenue recorded at December 31, 2002 and 2001 was $105 million and $94 million respectively.

Transportation and Storage Revenue

Revenue from the transportation and storage of gas was $179 million in 2002 compared with $151 million in 2001. This increase is due to a higher demand for storage and transactional services and the 2001 write-off of gas loans receivable from Enron.

Transportation and storage customers are primarily Canadian natural gas transmission and distribution companies. Approximately 71% of the Company's annual transportation and storage revenue is generated by fixed demand charges under contracts with remaining terms of up to 12.5 years and an average outstanding term of 3.8 years.

Other Revenue

Other revenue was $39 million in 2002 compared with $44 million in 2001. This decrease was primarily due to a loss of revenues earned on an investment held in 2001 but sold in early 2002 and lower delayed payment charges in 2002 resulting from a reduction in the rate charged on late payments and the lower cost of gas.

Expenses

Expenses include operating and maintenance expenses, depreciation and amortization, property and capital taxes, and other expenses.

Operating and maintenance expense was $282 million in 2002 compared with $254 million in 2001. This increase was primarily due to bad debt expense and severance costs.

Depreciation and amortization expense was $151 million in 2002 compared to $148 million in 2001. This increase was due to a higher investment in property, plant and equipment required to serve the expanding customer base.

Other expenses in 2002 include the write-down of assets relating to the Natural Gas Vehicle program, which amounted to approximately $10 million.

Interest Expense

Interest expense was $168 million in 2002 compared to $179 million in 2001. This decrease was predominantly due to lower average short-term debt outstanding together with a lower average cost of short-term debt.

Income Taxes

The Company accounts for income taxes using the flow through tax accounting methodology as approved by the OEB. Under flow through tax accounting, income tax expense is recorded on the basis of income taxes currently payable. Rates and revenues for utility operations include recovery of only such income taxes as are currently payable. Accordingly, the Company does not provide for income taxes deferred to future years as a result of differences in the treatment for income tax and accounting purposes of various items of income and expenditure. The only exception is that the Company calculates deferred income taxes on temporary differences between the approved cost and the actual cost of gas and other amounts deferred in accounts approved by the OEB.

Prior to 1997, the Company utilized the tax allocation method to account for income taxes. Under this method, provision was made for income taxes deferred principally as a result of claiming capital cost allowance for income tax purposes in excess of depreciation provided in the accounts. As approved by the OEB, this balance is reduced as the timing differences that gave rise to these deferred income taxes reverse. The timing differences are expected to reverse over approximately 16 years.

The effective rate of income taxes was 35.6 % in 2002 and 25.8% in 2001. The increase in the effective rate was primarily due to a difference in deductions claimed for income tax purposes compared to amounts recorded for accounting purposes. This was partially offset by reductions in federal and

provincial income tax rates. For 2003, the Company expects that a further reduction to the federal tax rate will continue as proposed by the government.

FINANCIAL CONDITION

Operations

Cash flow from operating activities was an inflow of $578 million in 2002 compared with an outflow of $44 million in 2001. The increase in operating funds in 2002 was principally due to a decrease in inventory levels as a result of colder weather and the collection of receivables for gas deferral balances and income taxes.

Investment Activities

Capital expenditures totalled $193 million in 2002 compared to $218 million in 2001. Of the total 2002 investment, 34% was spent on transmission and storage projects, 54% on distribution projects and 12% on projects of general equipment. These investments were necessary to meet the growth in customer demand for services. Capital expenditures are expected to be approximately $148 million in 2003.

During 2002 the Company redeemed its investment in UEI Holdings Inc., an affiliated company, for $150 million. The proceeds from the redemption were used to repay short-term indebtedness.

Liquidity and Capital Resources

The Company meets its cash requirements through funds generated from operations, issuance of short-term debt, long-term debt and preference shares, and common equity investment by the Company's parent.

The Company's lines of credit include a committed credit facility of $600 million with a one-year term that commenced in July 2002. During the term of the committed credit facility, the Company has the option to convert a portion of the drawings under the facility to loans not exceeding twelve months.

These lines of credit enable the Company to borrow directly from banks, issue bankers' acceptances and support a commercial paper program. Most of the short-term cash requirements are funded through issuing commercial paper at rates generally below prime.

The short-term borrowing levels fluctuate significantly during the year due to the funding of construction activities, the timing of long-term debt issues and other financing activities, and the seasonality of the Company's business. The peak borrowings during 2002 reached approximately $600 million in January.

The Company has a medium-term note (MTN) program that allows for the ongoing offering of unsecured MTN debentures under a shelf prospectus. The current shelf prospectus was filed in May 2002 and permits the issuance of medium-term notes in one or more series up to an aggregate principal amount of $400 million over its two-year life. The Company issued $200 million of the MTN debentures in December 2002. The proceeds from this issue were used to repay short-term indebtedness incurred to finance capital expenditures and for other corporate purposes.

Under its previous shelf prospectuses, which matured in June 2002 and June 2000, the Company had issued $250 million of MTN debentures in May 2001, $185 million of MTN debentures in May 2000 and

$100 million in July 1998. The proceeds from these issues were also used to repay short-term indebtedness incurred to finance capital expenditures and for other corporate purposes.

Long-term debt repayments in 2002 totalled $119 million. This amount included the redemption of the 10.625% senior sinking fund debentures in the amount of $36 million and the 9.7% senior debentures in the amount of $75 million. Long-term debt repayments on sinking funds totalled $8 million and $11 million in 2002 and 2001 respectively.

In order to maintain the common equity component of rate base as approved by the OEB, the Company's parent will periodically provide common equity. So as to maintain the common equity component of rate base at the level approved by the OEB, the Company paid a $100 million special dividend to its parent in May 2002.

During 2000, the Company acquired the tax loss carry-forwards of an affiliated company and issued 100,000 Class C, Series 1 preference shares in return. The redemption price of the shares was equal to the reduction in taxes payable realized by the Company, associated with the amounts transferred. The Company realized $4 million in tax savings in 2001 and a further $18 million in 2002. The total savings in 2002 were $4 million in excess of the amount originally estimated and as a result increased the value of these preference shares. During 2002 and 2001, the Company redeemed Class C, Series 1 preference shares totalling $18 million and $4 million respectively.

In July 2002, Standard & Poor's ("S&P") placed its ratings for Duke Energy and some of its subsidiaries, including Union, on Credit Watch with negative implications. In August 2002, Duke Energy was advised by S&P that its credit ratings and that of some of its subsidiaries, including the Company, would be lowered one level and S&P would change its negative outlook to stable. As a result, the Company's corporate credit rating was lowered from A+ to A, its unsecured debt was lowered from A+ to A and its preferred stock was lowered from P–1 (low) to P–2 (high). The Company's commercial paper ratings were not affected.

In January 2003, S&P again lowered its long-term ratings and also lowered the short-term ratings for Duke Energy and some of its subsidiaries. The Company's corporate credit rating was lowered from A to A-, its commercial paper was lowered to A–1 (low), its senior unsecured debt was lowered to A–, and its preferred stock was lowered to P–2 (mid). This action was based primarily on S&P's determination that reductions in capital and investment expenditures and planned asset divestitures will not be sufficient to provide funds needed to lower debt and reduce interest expense quickly enough to offset the impact of decreased earnings in 2002 and anticipated lower earnings in 2003.

The Company's capital instruments are rated as follows:

	Standard & Poor's	Dominion Bond Rating Service
Commercial paper	A – 1 (Low)	R – 1 (Low)
Debentures	A –	A
Preference shares	P – 2 (Mid)	Pfd – 2

GAS SUPPLY

The gas supply portfolio of the Company includes both fixed price contracts and contracts with pricing mechanisms that reflect monthly variations in the price of gas. These contracts are indexed to either the New York Mercantile Exchange (NYMEX) natural gas futures contracts or the Canadian Gas Price Reporter Alberta border average monthly price. Approximately 83% of the Company's forecast gas supply from January through October 2003 is subject to indexed prices.

The Company has a risk management policy that is designed to reduce the price volatility of its gas supply. Hedges are used to manage gas prices with respect to the underlying physical gas supply contracts and include the use of natural gas swaps and purchase price collars. During the year ended December 31, 2002, the Company hedged the purchase price applicable to 31% of its gas supply. At December 31, 2002, the Company had entered into natural gas hedged contracts to effectively fix the purchase price for approximately 412 10^6m^3 or 17% of the gas supply from January through October 2003.

In 2003, firm gas supply contracts represent approximately 39% of the Company's total forecast gas supply. Most of these contracts are subject to price re-determination prior to November 1, 2003. The remaining 61% is forecasted supply that has not yet been acquired.

Gas costs are included in customer rates based on forecasts approved by the OEB. Differences between the OEB approved reference prices and the actual cost of gas purchased, including the impact of both the indexed purchase prices and any hedging activities, are deferred for disposition as approved by the OEB.

ENVIRONMENT, HEALTH AND SAFETY MANAGEMENT PROGRAM

The Company highly values the health and safety of its employees, customers and communities. Protecting and responsibly managing natural resources are critical to the quality of life in the areas that the company serves, the environment and Union's long-term business success.

As a Duke Energy company, Union has continued its implementation of an environment, health and safety management system (EHS) to ensure continued compliance with applicable regulations and to provide a consistent approach to policies, programs and procedures. During 2002, the focus of the management system was on continued positive environment, health and safety performance and integration of EHS controls with those of Duke Energy.

The Company takes the climate change issue seriously and is working with industry to appropriately address this issue. Understanding that natural gas will continue to play an important role in meeting today's growing energy needs, the Company also encourages customers to use natural gas in the most efficient way possible.

OUTLOOK

Market

The outlook for the Company continues to be positive, supported by growing demand for natural gas, adequate existing and potential supply, additional transportation infrastructure and strong environmental support for natural gas as an appropriate alternative to other fuels. The Company's large and diverse customer base, extensive distribution system, and the strategic location of its storage and transmission

facilities, with interconnections between major U.S. markets in Michigan and New York state, will provide a sound basis for future growth.

During 2002, delivered natural gas pricing was competitive relative to oil pricing. This favourable pricing environment had a positive influence on industrial demand for natural gas. In 2003, cold weather and strong demand for natural gas is expected to drive natural gas prices higher in the heating season, while world events may drive higher oil prices that could create significant energy pricing volatility.

Strong economic growth is forecast in Ontario for 2003 and 2004, which may drive solid levels of construction and strong new customer growth. Significant consumer spending may create an opportunity to increase the penetration of natural gas appliances such as fireplaces and gas grills in the residential market. Increased industrial output may increase consumption by industrial users.

In 2002, the Ontario Government capped the price of electricity at 4.3 cents per kilowatt-hour for low volume users in Ontario through 2006. This cap may cause an artificially low price of electricity during this time frame. The price control may also slow the commercial viability of emerging distributed energy technologies such as microturbines and fuel cells, resulting in reduced potential to increase natural gas revenue in the small commercial and residential markets. This trend may be offset to some degree by the price advantage that natural gas continues to enjoy over electricity and oil in the core applications such as heating and water heating.

The regulatory and competitive environment in Ontario is evolving and the Company is adapting its business practices to meet these changes and maintain its competitive position in its markets. The Company is taking action to manage the risks and benefits from the opportunities presented in a more competitive environment, including the development of new service capability, and the implementation of a performance based method of regulation.

In December of 2002, the OEB issued rules regarding conditions of access to distribution services by customers and certain standards of business practice as they relate to gas marketers. Topics covered by the rule included customer connection and delivery obligations, consumer mobility, billing support services to marketers, prudential (credit) requirements, access to and use of customer information and compliance requirements. The rule requires distributors to facilitate the billing of their distribution services by Gas Vendors (Gas Vendor Consolidated Billing) for consumers purchasing the natural gas commodity from a Gas Vendor. The Company is contesting the jurisdiction of the OEB to require distributors to facilitate Gas Vendor Consolidated Billing and has appealed the rule to the Divisional Court of Ontario.

Risk Factors

The Company's earnings are affected by business risks inherent in the natural gas industry and energy marketplace. In general, the earnings level may be adversely affected by general economic conditions, the Company's ability to generate forecast revenues, warmer weather, declining use per customer, cost escalation, employee retention and the OEB's decisions with respect to rates.

Market Risk – Increased adoption of energy efficient technologies along with more efficient building construction techniques continues to place downward pressure on annual average consumption by residential and small commercial users. The Federal Government's ratification of the Kyoto Protocol will further raise awareness of efficiency and may increase the downward trend in consumption.

Technology issues combined with increased rental costs of residential gas water heaters threatens to decrease market share for natural gas water heaters. Union continues to aggressively defend the penetration of natural gas energy in this important market.

Sales to industrial customers are affected by economic conditions and the price of competitive energy sources. These sophisticated energy customers can readily switch between alternative fuels. Union will be working diligently to provide competitive delivered gas services to increase this market share for natural gas. In the Ontario gas fired electricity market, the availability of additional nuclear power and recent changes to electricity legislation in Ontario will create electricity supply and pricing uncertainty that will drive supply and pricing volatility in this highly competitive and sophisticated market.

The transportation and storage business is affected by competition for energy services in the North American energy marketplace, as well as economic conditions.

Commodity Price Risk – Fluctuations in natural gas prices affect the Company's gas purchase costs for its own operating requirements as well as the gas supply costs it incurs for, and collects from, its system customers. The Company manages this exposure through a risk management committee and policies and employs both fixed and variable price contracts. Hedges are used to fix gas prices with respect to the underlying indexed gas supply contracts and include the use of natural gas swaps, price caps and price collars.

Credit Risk – The Company, in the normal course of its operations, provides gas loans to other parties from its holdings of gas in storage. The replacement cost of the gas on loan at December 31, 2002 was $178 million. The Company manages its credit exposure related to gas loans by subjecting these parties to the same credit policies it uses for all customers. The Company maintains credit policies that management believes significantly minimize overall credit risk.

Weather Risk – The rates allowed by the OEB are based on volume forecasts that assume normal weather conditions. Since a large portion of the gas distributed to the residential and commercial market is used for space heating, differences from normal weather have a significant effect on the consumption of gas.

Weather normalization is a method used to estimate the average or typical annual weather effect on natural gas consumption for a future year. Prior to 2002, the Company used a 30-year rolling average of annual heating degree-days to forecast the weather effect on expected demand. This method for normalizing weather consistently overestimates the heating demand by customers by about 6.8% in a typical year. Beginning 2002, for internal purposes, the Company has moved to a 20-year trend for forecasting weather as this method more fairly reflects the observed warming trend on weather in recent years. The weather normalization assumptions used in setting rates approved by the Ontario Energy Board still reflect the 30-year rolling average methodology.

Regulatory Risk – The changes to the regulatory environment are increasing the risk of the business as more responsibility is placed on the Company to optimize its revenues and costs. The Company has also accepted more risk from a longer term PBR plan and floating inflation factor in its price cap formula than it previously incurred under an annual cost of service regime. The Company plans to manage these risks through profitable growth and cost efficiency opportunities. For 2004 Union plans to set rates using the traditional cost of service method.

Human Resources Risk – The Company's workforce consists of both unionized and non-unionized employees. Labour disruptions associated with the collective bargaining process can affect upon the Company's ongoing operations. h addition, the Company must maintain its ability to attract and retain employees with the requisite skills and capabilities to operate in the complex and competitive energy industry.

Other Risks – The Company has approximately 400 franchise agreements with municipalities in Ontario. These agreements set out the terms and conditions under which the Company conducts its business on municipal roadways. Currently the Company is responding to litigation to renew its franchise agreement with the Township of Pittsburgh, now part of the new amalgamated City of Kingston. The Company expects that it will receive a favourable court decision on this matter.

The Company currently has renewal applications before the Ontario Energy Board for the Municipalities of the City of Timmins, Township of Dawn and the City of Greater Sudbury. The Municipalities are requesting amendments to the 2000 Model Franchise Agreement that was approved and adopted by the Ontario Energy Board. The Company has negotiated the terms of the renewal of its franchise rights with the City of Greater Sudbury and the City of Timmins and has had same approved by the respective Municipal Councils. The Company expects that the Ontario Energy Board will approve the negotiated terms and will renew the Company's franchise rights for each of the Municipalities. The Company expects that the Ontario Energy Board will renew its franchise rights with the Township of Dawn in accordance with the 2000 Model Franchise Agreement.

Management Responsibility for Financial Reporting

The financial statements and all information in this report have been prepared by and are the responsibility of management. The financial statements have been prepared in conformity with Canadian generally accepted accounting principles and include certain estimated amounts, which are based on informed judgements to ensure fair representation in all material respects. When alternative accounting methods exist, management has chosen those it considers most appropriate.

Management depends upon the Company's system of internal controls and formal policies and procedures to ensure the consistency, integrity and reliability of accounting and financial reporting, and to provide reasonable assurance that assets are safeguarded and that transactions are properly executed in accordance with management's authorization. Management is also supported and assisted by a program of internal audit services.

The Board of Directors is responsible for ensuring that management fulfills its responsibility for financial reporting and for final approval of the financial statements. The Board of Directors performs this responsibility primarily through its Audit Committee.

The Audit Committee is comprised entirely of directors who are not employees of the Company.

The Audit Committee meets regularly with management, the internal auditors and the shareholders' auditors to review the financial statements, the Auditors' Report and other auditing and accounting matters to ensure that each group is properly discharging its responsibilities.

The shareholders' auditors have full and free access to the Audit Committee, as does the Director of Internal Audit Services. The Audit Committee reports its findings to the Board of Directors.

Deloitte & Touche LLP performed an independent audit of the 2002 financial statements in this report. Their independent professional opinion on the fairness of these financial statements is included in the Auditors' Report. Ernst & Young LLP, the predecessor auditor, performed an independent audit of the 2001 financial statements in this report.

January 14, 2003

Jane L. Peverett
President

Lindsay A. Hall
Vice President, Finance and Treasurer

AUDITORS' REPORT

To the Shareholders of Union Gas Limited

We have audited the balance sheet of Union Gas Limited as at December 31, 2002 and the statements of income, retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of Union Gas Limited as at December 31, 2002 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The financial statements as at December 31, 2001 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated January 25, 2002.

Deloitte & Touche LLP

Windsor, Ontario
January 14, 2003

Chartered Accountants

UNION GAS LIMITED
Statements of Income

For the Years Ended December 31 ($millions)	**2002**	2001
Gas sales and distribution revenue	**1,371**	1,688
Cost of gas (note 15)	**740**	1,084
Gas distribution margin	**631**	604
Transportation and storage revenue (note 15)	**179**	151
Other revenue	**39**	44
	849	799
Expenses		
Operating and maintenance (notes 13 and 15)	**282**	254
Depreciation and amortization (note 5)	**151**	148
Property and capital taxes	**59**	55
	492	457
Operating income	**357**	342
Other expenses	**12**	–
Earnings before interest and income taxes	**345**	342
Interest expense		
Long-term debt	**168**	168
Short-term debt (note 15)	**2**	13
Interest capitalized	**(2)**	(2)
	168	179
Income before income taxes	**177**	163
Income taxes (notes 2, 3 and 14)	**63**	42
Net income	**114**	121
Preference share dividend requirement	**5**	5
Earnings applicable to common shares	**109**	116

(See accompanying notes)

UNION GAS LIMITED
Statements of Retained Earnings

For the Years Ended December 31 ($millions)	**2002**	2001
Retained earnings, beginning of year	**447**	396
Net income	**114**	121
Dividends		
Preference shares	**5**	5
Common shares	**165**	65
Retained earnings, end of year	**391**	447

(See accompanying notes)

UNION GAS LIMITED
Balance Sheets

As at December 31 ($millions)	**2002**	2001
Assets		
Current assets		
Accounts receivable (notes 3 and 15)	**381**	556
Inventories (note 4)	**140**	239
Income taxes receivable	**67**	73
	588	868
Property, plant and equipment (note 5)	**3,091**	3,071
Investments and other assets (notes 6 and 13)	**198**	360
	3,877	4,299
Liabilities and Shareholders' Equity		
Current liabilities		
Short-term borrowings (notes 7 and 15)	**182**	601
Accounts payable and accrued charges (note 15)	**220**	210
Deferred income taxes (notes 3 and 14)	**44**	57
Long-term debt due within one year (note 8)	**8**	119
	454	987
Long-term debt (note 8)	**2,017**	1,825
Redeemable preference shares (note 9)	**5**	5
Deferred income taxes (note 2)	**278**	289
	2,754	3,106
Shareholders' equity		
Share capital (note 10)	**732**	746
Retained earnings	**391**	447
	1,123	1,193
	3,877	4,299

Contingencies and commitments (notes 11, 16 and 17)
(See accompanying notes)

Approved by the Board

Director

Director

UNION GAS LIMITED
Statements of Cash Flows

For the Years Ended December 31 ($millions)	**2002**	2001
Operating Activities		
Net income	**114**	121
Charges not affecting cash		
Depreciation and amortization	**153**	150
Loss on disposal of assets	**14**	–
Deferred income taxes	**(43)**	67
Non-cash working capital changes		
Accounts receivable	**175**	(209)
Inventories	**126**	(65)
Accounts payable and accrued charges and other	**39**	(108)
	578	(44)
Investing Activities		
Additions to property, plant and equipment	**(193)**	(218)
Decrease in investments and other assets	**141**	5
	(52)	(213)
Financing Activities		
(Decrease) increase in short-term borrowings	**(419)**	92
Long-term debt		
Issued	**200**	250
Retired	**(119)**	(11)
Preference shares redeemed	**(18)**	(4)
Dividends	**(170)**	(70)
	(526)	257
Change in cash during the year and cash, end of year	**–**	–

(See accompanying notes)

UNION GAS LIMITED
Notes to Financial Statements
December 31, 2002 and 2001

1. Significant Accounting Policies

Accounting Principles

The financial statements of Union Gas Limited ("the Company") have been prepared in accordance with Canadian generally accepted accounting principles. The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets, liabilities, revenues, expenses and disclosure of contingent assets and liabilities. Actual amounts could differ from these estimates.

Regulation

The utility operations of the Company are subject to regulation under the Ontario Energy Board Act and the Energy Act (Ontario). Rate schedules are approved periodically by the Ontario Energy Board (OEB) under a performance-based regulatory mechanism and are designed to permit a fair and reasonable return on the utility investment. Realization of the allowed rate of return is subject to actual operating conditions experienced during the year.

The Company is a rate-regulated, natural gas distribution utility and operates within southwestern, northern and eastern Ontario under franchise agreements with individual municipalities that are approved by the OEB.

The Company follows Canadian generally accepted accounting principles, which may differ in its regulated operations from those otherwise expected in non-regulated businesses. These differences occur when the regulatory agencies render their decisions on the Company's rate applications and generally involve the timing of revenue and expense recognition to ensure that the Company has achieved a proper matching of revenues and expenses. In addition to defining certain accounting requirements, the regulatory agencies have jurisdiction over a number of other matters, which include the rates to be charged for the storage, transmission and distribution of gas and approval and recovery of costs for major construction and operations.

As part of Performance Based Regulation ("PBR"), the Company is required to go through a customer review process. The customer review process is a settlement negotiation that addresses the specific PBR parameters for the applicable period and other matters such as the disposition of deferral accounts. A hearing is then held before the OEB to approve the settlement and hear evidence on unresolved issues.

In September 2002, the OEB issued its decision on the Company's application for 2001 and 2002 rates. The OEB approved inflation factors of 3.9% and 2.0% to be used in the Company's rate escalator formula for 2001 and 2002, respectively, resulting in an increase in customer rates of 1.4% in 2001 and a decrease of 0.5% in 2002. The OEB also approved the pass through to customers of the impact of changes in gas costs during 2000 and 2001. The recovery of the revenue resulting from approved rate changes and deferred gas costs amounting to approximately $141 million will be charged to customers in the period January through June 2003. The OEB decision had no material effect on earnings for 2002 as the Company had already accrued most of the costs and benefits in prior periods in anticipation of receiving the order.

The Company is currently undergoing the process of seeking approval of its 2003 rate proposals. The Company received OEB approval in February 2003 of the settlement agreement negotiated in a customer review meeting in

January 2003. A hearing was held with the OEB in February 2003 to resolve various outstanding issues relating to the 2003 year. A decision is pending.

Gas Sales and Cost of Gas

Gas sales revenue is recorded on the basis of regular meter readings and estimates of customer usage since the last meter reading date to the end of the reporting period. Cost of gas is recorded using prices approved by the OEB in the determination of customer sales rates. Differences between the OEB approved reference prices and those costs actually incurred are deferred for future disposition subject to approval by the OEB.

In the matching of gas sales revenue and cost of gas sold, differences arise from the measurement process. The Company includes in the cost of gas an estimated amount of these differences based upon the methodology recognized by the OEB in the determination of rates for storage transmission and distribution of gas. Annual fluctuations from the estimated level are deferred and amortized over a period of three years.

Income Taxes

The Company records income tax expense for its regulated operations using the flow through tax accounting methodology as approved by the OEB. Under flow through tax accounting, income tax expense is recorded on the basis of income taxes currently payable. Rates and revenues for utility operations include recovery of only such income taxes as are currently payable. Accordingly, the Company does not provide for income taxes deferred to future years as a result of differences in the treatment for income tax and accounting purposes of various items of income and expenditure. The only exception is that the Company calculates deferred income taxes on temporary differences between the approved cost and the actual cost of gas and other amounts deferred in accounts approved by the OEB. The flow through tax accounting methodology is followed for accounting purposes as there is reasonable expectation that all such taxes will be recovered when they become payable.

Prior to 1997, the Company utilized the tax allocation method to account for income taxes. Under this method, provision was made for income taxes deferred principally as a result of claiming capital cost allowance for income tax purposes in excess of depreciation provided in the accounts. Note 2 describes the method for disposition of the accumulated deferred tax balance.

Inventories

Gas in storage for resale to customers is carried at prices approved by the OEB in the determination of customer sales rates. The difference between the approved price and the actual cost of the gas purchased is deferred for future disposition by the OEB. Inventories of materials and supplies are valued at the lower of average cost, replacement cost and net realizable value.

Property, Plant and Equipment and Depreciation

Property, plant and equipment are carried at cost which includes all direct costs, overhead attributable to construction and interest capitalized during construction. The cost of property, plant and equipment is reduced by contributions and grants in aid of construction received from customers and governmental bodies in support of specific transmission and distribution facilities.

Removal and site restoration costs are not determinable and will be recorded when reasonably estimable. The original cost of depreciable units retired, together with the net cost of removal less salvage, is charged to accumulated depreciation. Under this method, no income or loss is recognized on ordinary retirements of depreciable property.

Depreciation is provided on the straight-line method at various rates based on the average service life of each class of property, ranging from 4 to 60 years. Depreciation rates are determined by periodic review and approved by the OEB.

Deferred Charges

Costs as required or permitted by the regulators have been deferred to be recovered from future revenues. Certain regulatory deferrals are subject to future decisions by the relevant regulators who will determine the treatment to be given the various items.

Costs related to long-term debt are deferred and amortized on a straight-line basis over the term of the respective debt issues.

Goodwill

Goodwill is included in Other Assets and represents the excess cost of an investment over the fair value of the net assets acquired. Goodwill is not amortized and will be written down to net recoverable value if declines in value, considered to be other than temporary, occur based upon a fair-value based annual impairment assessment.

Employee Benefit Plans

The Company uses the projected benefit method prorated on service to account for defined benefit pensions and other post employment benefits earned by employees.

The Company accrues its obligations under employee benefit plans and the related costs, net of plan assets. The plan assets are valued at fair value. The calculation of the expected return on assets is based on the market-related value of assets.

Past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment.

The excess of the net unamortized cumulative actuarial gain or loss over 10 per cent of the greater of the benefit obligation and the market-related value of plan assets at the beginning of the year is amortized over the average remaining service period of the active employees.

The average remaining service period of active employees covered by both the pension plans and the other retirement benefits plans are 17 years.

For defined contribution plans maintained by the Company, contributions payable by the Company are expensed as pension costs.

Natural Gas Swap and Other Contracts

The Company's gas supply portfolio includes contracts with pricing mechanisms that reflect monthly variations in the price of gas, rather than fixed prices. In order to manage price volatility, hedges are used to fix gas prices with respect to the underlying physical gas supply contracts. The hedges include the use of natural gas swaps and purchase price collars. The actual cost of gas purchased includes the impact of any hedging activities related to these contracts. The Company negotiates natural gas swap and purchase price collar contracts only with those institutions that have a credit rating of A or higher.

Comparative Figures

Certain comparative figures have been reclassified to conform to the presentation adopted in 2002.

2. Long-term Deferred Income Taxes

In 1997, following approval by the OEB, the Company changed its accounting for income taxes related to utility operations from the tax allocation method to flow through tax accounting consistent with the determination of 1997 rates. This change was applied prospectively since the basis for determining the Company's rates and revenues for utility operations were previously established taking into account the provision for income taxes based on the tax allocation methodology.

The long-term deferred tax balance of $278 million at December 31, 2002 (2001 - $289 million) includes $268 million (2001 - $282 million) that arose from using the tax allocation methodology related to utility operations. As approved by the OEB, this balance is reduced as the timing differences that gave rise to these deferred income taxes reverse. The timing differences related to utility operations are expected to reverse over approximately 16 years.

3. Income Tax Treatment of Gas Cost and Other OEB Approved Deferral Accounts

The Company has a balance of $126 million receivable (2001 - $204 million receivable) that represents income tax temporary differences related to gas costs and other amounts deferred in accounts approved by the OEB.

The Company is required to deduct from or include in taxable income the actual amounts incurred related to these deferral accounts. The change in the deferral account balances during the year resulted in an increase in taxable income of $78 million (2001 - $218 million decrease). The Company recorded a deferred income tax recovery of $32 million (2001 - $79 million expense) with respect to these amounts.

4. Inventories

($millions)	**2002**	2001
Gas in storage	**116**	213
Materials and supplies	**24**	26
	140	239

5. Property, Plant and Equipment

($millions)	**2002**	2001
Cost		
Distribution	**2,677**	2,577
Transmission	**1,096**	1,053
Storage	**584**	575
General	**234**	270
	4,591	4,475
Accumulated depreciation		
Distribution	**899**	831
Transmission	**350**	324
Storage	**158**	141
General	**93**	108
	1,500	1,404
Net book value	**3,091**	3,071

Gas distribution plant is net of contributions in aid of construction of $162 million (2001 - $158 million). Depreciation rates used during the year ended December 31, 2002 resulted in a composite rate of 3.47% (2001 – 3.51%). In 2002, $2 million (2001 - $2 million) of depreciation was allocated to operating and maintenance expense rather than to depreciation and amortization expense shown on the Statements of Income.

Property, plant and equipment include assets that are not subject to depreciation totalling $94 million (2001 - $118 million). These assets include land, base pressure gas in storage reservoirs and assets under construction.

6. Investments and Other Assets

($millions)	**2002**	2001
UEI Holdings Inc. 5.2% cumulative redeemable preferred shares (a)	–	150
Gas for balancing direct purchase customers (b)	**143**	164
Deferred charges and other	**55**	46
	198	360

(a) During the year, the Company redeemed the UEI Holdings Inc. 5.2% preferred shares in the amount of $150 million.

(b) Bundled delivery service customers are required to balance their gas supply and gas consumption annually. To provide this service the Company owns gas to meet the customers' demand for gas during the year. This balancing gas is recorded at cost.

7. Short-term Borrowings

The Company has total bank lines of credit of $625 million. The lines of credit include a committed credit facility of $600 million with a one-year term that commenced in July 2002, and a $25 million operating facility. During the term of the committed credit facility, the Company has the option to convert a portion of the drawings under the facility to loans not exceeding twelve months. The bank lines of credit are unsecured.

These lines of credit enable the Company to borrow directly from banks, issue bankers' acceptances and support a commercial paper program. A majority of the short-term cash requirements are funded through issuing commercial paper at rates generally below prime. The average interest rate on short-term borrowings for the year ended December 31, 2002 was 2.8% (2001 – 4.3%).

Total short-term interest paid in 2002 was $8 million (2001 - $16 million).

8. Long-term Debt

($millions)		**2002**	2001
Sinking fund debentures			
11.55%	1988 Series II debentures, due October 15, 2010	**65**	69
13.50%	Senior debentures, due November 14, 2008	**8**	9
10.625%	Senior debentures, due January 7, 2002	**–**	36
10.75%	Senior debentures, due July 31, 2009	**42**	45
Other long-term debt			
10.625%	1989 Series debentures, due July 11, 2011	**125**	125
11.50%	1990 Series debentures, due August 28, 2015	**150**	150
9.70%	1992 Series II debentures, due November 6, 2017	**125**	125
8.75%	1993 Series debentures, due August 3, 2018	**125**	125
7.90%	1994 Series debentures, due February 24, 2014	**150**	150
9.75%	1994 Series II debentures, due December 13, 2004	**125**	125
8.65%	1995 Series debentures, due November 10, 2025	**125**	125
9.70%	Senior debentures, due December 9, 2002	**–**	75
8.65%	Senior debentures, due October 19, 2018	**75**	75
8.85%	Senior debentures, due September 1, 2005	**100**	100
7.80%	Senior debentures, due December 1, 2006	**75**	75
Medium-term note debentures			
5.70%	Series 1, due July 14, 2008	**100**	100
7.20%	Series 2, due June 1, 2010	**185**	185
6.65%	Series 3, due May 4, 2011	**250**	250
5.19%	Series 4, due December 17, 2007	**200**	–
		2,025	1,944
Less: current portion		**8**	119
		2,017	1,825

The Company's long-term debt is unsecured. The weighted average cost of long-term debt for the year ended December 31, 2002 was 8.7% (2001 - 8.9%). Principal repayment requirements on long-term debt are as follows:

	($millions)
2003	8
2004	133
2005	108
2006	83
2007	208
Thereafter	1,485
Total	2,025

Under the terms of the trust indentures relating to certain debentures, the Company has agreed to limit the payment of dividends and to meet certain interest coverage ratios prior to the issue of additional long-term debt. The Company is in compliance with all such covenants.

Total interest paid on long-term debt in 2002 was $169 million (2001 - $163 million).

9. Redeemable Preference Shares

		2002	2001
Authorized	**Issued**	*($millions)*	
Class A - 112,072	51,372 Series A, 5.5% (2001 - 52,072)	**3**	3
	49,500 Series C, 5%	**2**	2
		5	5
Less: current portion		**–**	–
		5	5

The Class A Preference Shares, Series A and C are cumulative and redeemable at $50.50 per share. Through the operation of a purchase fund the Company is obligated to offer to purchase $170,000 of Series A and $140,000 of Series C shares annually at the lowest price obtainable but not exceeding $50 per share.

10. Share Capital

		2002	2001
Authorized	**Issued**	*($millions)*	
Preference shares			
Class A - 90,000	90,000 - Series B, 6%	**5**	5
Class B - unlimited	4,000,000 - Series 10, 4.88%	**100**	100
Class C - unlimited	Nil (2001- 75,000) - Series 1	**–**	14
		105	119
Common shares - unlimited	57,822,650	**627**	627
		732	746

The Class A Preference Shares, Series B are cumulative and redeemable at $55 per share.

The Class B Preference Shares, Series 10 are cumulative and redeemable at the Company's option and convertible into Class B Preference Shares, Series 11 every five years commencing January 1, 2004. The dividend rate is fixed until December 31, 2003, at which point the dividend will become floating at an annual rate of 80% of the prime rate.

The Class C Preference Shares, Series 1 were cumulative and mandatorily redeemable on a quarterly basis if in that quarter the Company's corporate tax instalment, which would otherwise have been payable but for the utilization of the Union Energy Inc. (UEI) losses (note 15), is reduced as a result of the use by the Company of the UEI losses. The redemption price of the shares was equal to the reduction in taxes payable realized by the Company, associated to the amounts transferred. The company realized $4 million in tax savings in 2001 and a further $18 million in 2002. The total savings in 2002 were $4 million in excess of the amount originally estimated and as a result increased the value of these preference shares. During 2002 and 2001, the Company redeemed Class C, Series 1 preference shares totalling $18 million and $4 million respectively.

11. Risk Management

Natural Gas Swap Contracts

The purchase price applicable to approximately 83% of the Company's forecast gas supply from January through October 2003 is indexed to either the New York Mercantile Exchange Natural Gas Futures contracts or the Canadian Gas Price Reporter Alberta border average monthly price. At December 31, 2002, the purchase price applicable to 412 $10^6 m^3$ or 17% of this indexed supply has been effectively fixed through the use of natural gas swap contracts and purchase price collars that mature prior to April 2003.

Credit Risk

The Company, in the normal course of its operations, provides from its holdings of gas in storage, gas loans to other parties. The replacement amount of gas loans at December 31, 2002 was $178 million (2001 - $140 million). The Company manages its credit exposure related to gas loans by subjecting these parties to the same credit policies it uses for all customers. The Company maintains credit policies which management believes significantly minimizes overall credit risk.

12. Fair Values of Financial Assets and Liabilities

The following fair value information is provided to comply with financial instrument disclosure requirements. Fair values have been estimated by reference to quoted market prices for the actual or similar instruments where available. The fair value of accounts receivable and current liabilities approximated their carrying amounts in the financial statements due to the relatively short period to maturity of these instruments. The carrying values and fair values of the Company's other financial instruments are as follows:

($millions)	**2002**		2001	
	Carrying Value	**Fair Value**	Carrying Value	Fair Value
Assets				
UEI Holdings Inc. preferred shares	–	–	150	150
Liabilities				
Natural gas swap contracts	–	**(2)**	–	(13)
Long-term debt	**2,025**	**2,321**	1,944	2,245
Redeemable preference shares	**5**	**5**	5	5

Under the regulatory process, the Company recovers the cost of natural gas and the weighted average cost of its long-term debt through its rate setting mechanism. Accordingly, the Company cautions readers that estimated fair values may not be relevant for their purposes.

13. Employee Future Benefits

The Company has defined benefit pension plans, defined contribution pension plans and defined benefit plans providing retirement and post-employment health and life insurance benefits for most employees. The defined contribution pension expense for the year ended December 31, 2002 was $3 million (2001 - $3 million).

Information about the defined benefit plans, in aggregate, for the years ended December 31, 2002 and 2001 are as follows:

	Pension Benefit Plans		Other Benefit Plans	
($millions)	**2002**	2001	**2002**	2001
Accrued benefit obligations				
Balance, beginning of year	**354**	354	**26**	42
Current service cost	**7**	7	**1**	1
Interest cost	**25**	24	**2**	3
Benefits paid	**(26)**	(24)	**(2)**	(1)
Prior service costs	–	5	–	–
Actuarial loss (gain)	**30**	(12)	**10**	(19)
Defined contribution conversion	**(4)**	–	–	-
Balance, end of year	**386**	354	**37**	26
Plan assets				
Fair value, beginning of year	**314**	389	–	–
Return on plan assets	**(5)**	(64)	–	–
Employer contributions	**11**	11	2	2
Employees' contributions	**2**	2	–	–
Benefits paid	**(27)**	(24)	(2)	(2)
Defined contribution conversion	**(3)**	–	–	–
Fair value, end of year	**292**	314	–	–
Funded status - plan deficit	**(94)**	(40)	**(37)**	(26)
Unamortized net actuarial loss (gain)	**108**	43	**(8)**	(19)
Unamortized prior service costs	**5**	5	–	–
Unamortized transitional obligation	**20**	22	**33**	35
Contributions remitted after measurement date	**2**	2	**1**	–
Accrued benefit asset (liability)	**41**	32	**(11)**	(10)

The non-pension defined benefit plans are unfunded.

For 2002, all of the defined benefit pension plans have accrued benefit obligations that exceed the fair value of plan assets. For 2001, certain defined benefit pension plans have accrued obligations ($342 million) that exceed the fair value of plan assets ($300 million).

The following is a summary of the weighted average significant actuarial assumptions used in measuring the Company's accrued benefit obligations:

	Pension Benefit Plans		Other Benefit Plans	
	2002	2001	**2002**	2001
Discount rate	**6.50%**	7.25%	**6.50%**	7.25%
Expected long-term rate of return on plan assets	**7.75%**	8.50%	**N/A**	N/A
Rate of compensation increase	**3.25%**	3.25%	**3.25%**	3.25%

In addition, in determining the expected cost of health care benefit plans, it is assumed that the inflationary increase of health care costs will decrease gradually from 10% in 2002 to 5% in 2008 and remain level thereafter.

The Company's net benefit plan expense was as follows:

	Pension Benefit Plans		Other Benefit Plans	
($millions)	**2002**	2001	**2002**	2001
Current service cost	**5**	5	**1**	1
Interest on projected benefit obligation	**25**	24	**2**	3
Return on plan assets	**(30)**	(29)	**–**	–
Amortization of actuarial losses	**–**	–	**(1)**	–
Amortization of transitional obligation	**2**	2	**2**	2
Net benefit plan expense	**2**	2	**4**	6

14. Income Taxes

The provision for income taxes consists of the following:

($millions)	**2002**	2001
Current	**106**	(25)
Deferred	**(43)**	67
	63	42

A reconciliation between the combined Federal and Ontario statutory tax rate and the effective rate of income taxes is as follows:

($millions)	**2002**	2001
Income before income taxes	**177**	163
Statutory income tax rate (percent)	**37.5**	40.6
Statutory income tax rate applied to accounting income	**66**	66
Increase (decrease) resulting from:		
Dividend income	**–**	(3)
Large corporations tax	**8**	9
Deductions claimed for income tax purposes less than (in excess of) amounts recorded for accounting purposes	**5**	(7)
Deferred income tax rate adjustments	**(2)**	(8)
Loss for tax purposes carried back to prior year	**–**	(4)
Amortization of deferred income taxes	**(14)**	(11)
Provision for income taxes	**63**	42
Effective rate of income taxes (percent)	**35.6**	25.8

Total income taxes paid in 2002 were $90 million (2001 - $37 million).

In the event that the Company had implemented the liability method to account for income taxes, the deferred income tax liabilities and deferred income tax expense would have been:

	Liability Method		Flow Through Method	
($millions)	**2002**	2001	**2002**	2001
Current deferred income tax liability	**41**	53	**44**	57
Long-term deferred income tax liability	**395**	397	**278**	289
Deferred income tax (recovery) expense	**(33)**	52	**(43)**	67

15. Related Party Transactions

a. The Company purchases transportation services at prevailing market prices and under normal trade terms from commonly controlled companies. During the year ended December 31, 2002, these purchases totalled $74 million (2001 - $53 million). The Company also provides storage and transportation services to commonly controlled companies under normal trade terms. During the year, this revenue totalled $11 million (2001 - $4 million).

b. The Company provided administrative, management and other services to commonly controlled companies totalling $5 million (2001 - $5 million), which were recovered at cost. Charges from related parties for administrative and other goods and services were $17 million (2001 - $13 million).

c. The Company received dividends from the UEI Holdings Inc. (UEIH) cumulative redeemable preferred shares of $1 million (2001 - $8 million). The company redeemed these shares during the year (note 6).

d. At December 31, 2002, the Company has intercompany receivable balances of $2 million (2001 - $5 million) and intercompany payable balances of $13 million (2001 - $3 million), which are recorded in accounts receivable and accounts payable respectively. During the year, the Company obtained unsecured loans from its parent company, Westcoast Energy Inc. The balance of these loans at December 31, 2002, was $nil (2001 - $117 million) and the interest paid on these loans was based on the monthly average of 30-day banker's acceptance rates (2.8% at December 31, 2002) and totalled $0.5 million (2001 - $4 million).

e. In December 2000, Union Energy Inc. (UEI) and UEIH, companies related to the Company through common control, completed a corporate reorganization. The corporate reorganization transferred all of the assets and liabilities of UEI to another company controlled by UEIH. The only remaining asset of UEI was a deferred income tax asset associated with losses from prior years, which can be applied to future years' income tax liabilities. Subsequent to the reorganization, the Company purchased all the outstanding shares of UEI from UEIH, in exchange for 100,000 Class C, Series 1 redeemable preference shares of the Company. The transaction was recorded at $18 million, which is equal to the redemption value of the preference shares and the book value of the deferred income tax asset. During the year, the company redeemed all of the outstanding Class C, Series 1 redeemable preference shares (note 10).

16. Commitments

The Company and an affiliated company have entered into contracts with a counter party to mitigate the risk of warm weather during 2003. The hedge contract provides protection against warm weather and the Company is obligated to make a payment to the counter party for cold weather. The maximum payout under the hedge is $25 million. Any payment would be recorded as a reduction of the Company's gas sales and distribution revenues. In conjunction with this contract, the Company received an amount of $4.5 million from the counter party for selling the portion of the contact related to the potential for colder weather. The $4.5 million has been recorded as a current liability.

The Company entered into a weather hedge with a third party in order to mitigate the risk of warm weather during November and December 2002. As a result of this weather hedge, the Company has a payable balance of $2 million at December 31, 2002.

17. Contingencies

The Company, in the course of its operations, is subject to environmental and other claims, lawsuits and contingencies. Accruals are made in instances where it is probable that liabilities will be incurred and where such liabilities can be reasonably estimated. Although it is possible that liabilities may be incurred in instances for which no accruals have been made, the Company has no reason to believe that the ultimate outcome of these matters would have a significant impact on its financial position.

STATEMENT OF CORPORATE GOVERNANCE PRACTICES

General

The Board believes that a sound and effective corporate governance system is essential to the well being of the Corporation and its shareholders. The Board has carefully considered the corporate governance guidelines adopted by The Toronto Stock Exchange ("TSX guidelines") and has put in place suitable and effective processes and structures to guide the direction and management of the business and affairs of the Corporation.

Board of Directors

The Board oversees the conduct of the business of the Corporation and the activities of management. Management is responsible for the day-to-day operations of the business. The Board acts independently of management either directly or through the Audit Committee of the Board which is delegated some of the Board's responsibilities. The Board's fundamental objectives are to enhance and preserve long-term shareholder value and to ensure the Corporation meets its obligations on an ongoing basis and operates in a reliable and safe manner.

Composition of the Board

The Board is comprised of 5 directors which it believes is adequate, in current circumstances, to effectively discharge its responsibilities. All of the voting shares of the Corporation are held by Westcoast Energy Inc. ("Westcoast"). Westcoast is therefore the significant shareholder of the Corporation.

Based on an assessment of each individual director's relationship with the Corporation and with others having relationships with the Corporation, the Board has concluded that 4 of the 5 directors of the Corporation are unrelated. In conducting its analysis, the Board applied the definition of an unrelated director as one who is independent of management and is free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director's ability to act with a view to the best interests of the Corporation, other than interests and relationships arising from shareholdings. Mr. Brown is an unrelated director. Mr. O'Connor is a full-time officer of Duke Energy Gas Transmission Corp., an affiliate of the Corporation and an affiliate of Westcoast, the Corporation's significant shareholder. Mr. O'Connor is an unrelated director under the TSX guidelines. Mr. Willms retired as President and Chief Operating Officer of Westcoast on October 31, 1999 after holding various positions within Westcoast since 1971. He also provided services to the Corporation until April 30, 2002 and is a director of several significant affiliates of the Corporation. He is unrelated under the TSX guidelines. Mr. Unruh retired as the Senior Vice President and General Counsel of Westcoast effective April 1, 2003 and is a director of several significant affiliates of the Corporation. He is an unrelated director under TSX guidelines. Ms. Peverett is a full-time officer of the Corporation and is therefore considered to be a related director.

The Corporation is of the view that the composition of the Board fairly reflects the investment in the Corporation by shareholders other than Westcoast, the holder of 100% of the issued and outstanding voting shares of the Corporation.

Responsibilities of the Board

The Board discharges its responsibilities directly and through the Audit Committee. In addition to those matters which in law must be approved by the Board, the Board retains the responsibility for the approval of matters of a material nature including the approval of major transactions, the approval of the strategic plan, the approval of the annual operating and capital budgets, capital expenditures and financial commitments above approved minimum thresholds, the approval of the Corporation's dividend

policy and the monitoring of the principal risks of the business and activities of the Corporation. It also manages its own affairs including the development of the Board's meeting agendas, the nomination of candidates for election to the Board, membership to committees of the Board and director's compensation.

The Board has retained responsibility for the Corporation's governance system and is responsible for establishing criteria for Board membership, composition of the Board and the Audit Committee, assessing directors' and Board performance on an ongoing basis and ensuring that there is in place an orientation and education program for new members of the Board.

The Board is responsible for searching for and recommending to the significant shareholder new candidates for election to the Board. In identifying such candidates for election, the Board seeks to select well-qualified candidates with a diversity of background, experience and expertise to maintain a well-balanced and highly competent group of directors with the ability to act together effectively. Special attention is given to candidates who have broad business exposure and are financially literate.

The Board is responsible for reviewing human resources and compensation policies, including directors' compensation and guidelines for application to the Corporation. It is also responsible for ensuring that the Corporation has a process to provide for the development and orderly succession of the Corporation's senior management personnel.

The Board is responsible for reviewing and monitoring the environmental policies and activities of the Corporation and the activities of the Corporation as they relate to the health and safety of the Corporation's employees in the workplace.

The Board expects management to be accountable for the Corporation's financial and competitive performance at a high standard consistent with enhancing the Corporation's value. It also expects management to provide to the Board timely, complete and accurate information on the business operations of the Corporation and to provide for the development of its executives and a plan for their succession. The Board has implemented structures and procedures to ensure it can function independently of management. The Chair of the Board is an unrelated director and at each meeting of the Board, the outside directors meet in-camera without members of management present.

Audit Committee

The Board has an Audit Committee that meets regularly and operates under terms of reference approved by the Board. These terms of reference are reviewed periodically and modified where appropriate. The Audit Committee is chaired by an outside and unrelated director and is composed entirely of unrelated directors. A calendar of activities for the Audit Committee is prepared annually and approved by the Board.

The Audit Committee is responsible for ensuring that the Corporation's management has designed and implemented an effective system of internal financial controls and financial reporting. It is also responsible for ensuring compliance with regulatory and statutory requirements as they relate to financial statements, taxation matters and the disclosure of material facts. As part of its function, the Audit Committee monitors the appropriateness and effectiveness of the Corporation's policies and business practices which impact on the financial integrity of the Corporation, including those relating to internal auditing, insurance, accounting, information services and systems and financial controls, management reporting and risk management. The Audit Committee conducts a review, with the Corporation's external auditors to satisfy itself of their independence as auditors.

At each meeting of the Audit Committee, members meet in-camera with internal and external auditors without management present.

DIRECTORS

Thomas C. O'Connor
Chair

David G. Unruh[1]
Vice Chair

Jane L. Peverett
Corporate Director

Arthur H. Willms[1]
Corporate Director

William C. Brown[1]
Corporate Director

[1] *member of the Audit Committee*

OFFICERS

Thomas C. O'Connor
Chair

Jane L. Peverett
President

Dorothy M. Ables
Senior Vice President

Stephen W. Baker
Vice-President, Gas Supply

M. Richard Birmingham
Vice-President, Regulatory Affairs and Business Services

Bohdan I. Bodnar
Vice President, Human Resources

Joachim W. Castelsky
Assistant Treasurer

Stephen G. DeMay
Vice President

Lawrence W. Fedchun
Assistant Secretary

Lindsay A. Hall
Vice President, Finance and Treasurer

Alan N. Harris
Executive Vice President

Leigh A. Hodgins
Assistant Secretary

Christine L. Jackson
Assistant Secretary

Phil Knoll
Executive Vice President

Sherwood L. Love
Assistant Treasurer

Anna Marks
Controller

Bruce Pydee
Vice President and General Counsel

Kelly Stark-Anderson
Corporate Secretary

R. Sean Trauschke
Assistant Treasurer

John W. Wellard
Vice-President, Sales and Marketing

Mel Ydreos
Vice-President, Operations

CORPORATE INFORMATION

Transfer Agent and Registrar
CIBC Mellon

Union Gas Limited preference shares are listed on the Toronto Stock Exchange
Class A - 5½% (UNG.PR.C)
Class A – 6% (UNG.PR.D)

REGISTERED OFFICE
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Chatham, Ontario
N7M 5M1

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